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ESTATE PLANNING: A CONSIDERATION OF SELECTED DIFFERENCES BETWEEN SOUTH CAROLINA AND FEDERAL ESTATE AND GIFT TAX LAW AND POSSIBLE TAX SAVINGS THEREFROM

INTRODUCTION

The 1976 Tax Reform Act¹ has affected estate planning to an extent heretofore unparalleled; the changes and additions to the body of federal estate and gift tax law are myriad and far-reaching. Since the Act's passage, estate planners have been scurrying to formulate new planning devices, to remodel old plans rendered inefficient, and to quest for the elusive loophole. Few would deny the impact of the reform on federal tax planning. Yet the new federal tax system also has a profound effect on state estate planning. South Carolina estate and gift tax law now differs from the federal law in many respects. Several of these differences are vastly important to the formulation of an estate plan for a South Carolina resident. A working knowledge of the disparity between the bodies of state and federal law may result in tax savings in particular, and in a more effective estate plan in general. This note will examine in section I the differences between selected areas of South Carolina and federal estate tax law. In section II, this note will examine how some of these differences affect estate planning in South Carolina, especially for tax-saving devices such as the minimization of South Carolina taxes in estates small enough to escape federal taxation, the making of gifts prior to the date of death, and the creation of generation-skipping transfers.

I. SOME DIFFERENCES BETWEEN SOUTH CAROLINA AND FEDERAL ESTATE AND GIFT TAX LAW

A. General Considerations

Most of the differences between South Carolina and federal estate and gift tax law, except for the rate schedules and some administrative procedures, exist because South Carolina law is based upon federal tax law prior to the 1976 Tax Reform Act.²

1. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976) (codified at scattered sections of I.R.C.).

2. See, e.g., S.C. CODE ANN. § 12-15-40 (Cum. Supp. 1977).

Although recent amendments to the South Carolina Code bring state law more into line with the present federal provisions,³ these recent changes are relatively few. This section will first present an overview of the changes promulgated by the 1976 Tax Reform Act and the corresponding provisions, if any, of the South Carolina Code, followed by a more concentrated examination of the differences between specific provisions in each.

Perhaps the major reform wrought by the Tax Reform Act was the introduction of a unified estate and gift tax system. The system is now unified in the sense that gifts are taken into consideration in the computation of estate taxes. The new system taxes the cumulation of transfers both during lifetime and at death, rather than taxing each separately as before.⁴ The gift tax rates, formerly three-fourths of the estate tax rates for corresponding brackets, are now equal to the estate tax rates.⁵ Instead of the specific exemptions provided by pre-1976 law, Internal Revenue Code (I.R.C.) sections 2010 and 2505 allow unified credits against both estate and gift taxes. An exemption excludes property from taxable consideration to the extent of that exemption. A credit reduces the amount of tax liability being subtracted from that liability to the extent of the credit. The credits against estate and gift taxes are being phased in through 1981; the credits will be \$47,000 in 1981 and thereafter.⁶ A \$47,000 credit would be approximately equal to a \$175,000 exemption. This note will assume that all taxable transfers examined herein are made after 1981, unless otherwise specified.

Furthermore, the contemplation-of-death rule⁷ has been modified; lifetime transfers are included in the gross estate if made within three years of the date of the taxpayer's death.⁸ The formulas for establishing both the estate tax marital deduction ceiling and the gift tax marital deduction ceiling have been modified; the estate tax marital deduction ceiling may be further modified by the earlier use of a gift tax marital deduction for a lifetime transfer.⁹ I.R.C. section 2040, which provides for the in-

3. See No. 539, 1978 S.C. Acts 1574.

4. I.R.C. § 2001(b). Unless otherwise specified, reference to lifetime transfers will assume that such transfers are taxable as gifts. See text accompanying notes 29-31, *infra*.

5. I.R.C. § 2502(a). See text accompanying note 28, *infra*.

6. *Id.* §§ 2010, 2505. See text accompanying notes 32-37, *infra*.

7. See text accompanying notes 65-66, *infra*. See section I.D.1 of this note.

8. *Id.* § 2035(a). Also, the new "gross-up" rule brings back into the gross estate any gift tax paid within three years of death. *Id.* (c). See discussion in section I.D.2. of this note.

9. *Id.* § 2056(c); see *id.* § 2523. See text accompanying notes 49-51, 57, *infra*.

clusion in the gross estate of joint interests held by the decedent, has been amended.¹⁰ New methods for alternate valuation of property interests have been added,¹¹ as well as methods for extending the time to pay the estate tax.¹² An important loophole-closing device is the imposition of a tax on generation-skipping transfers, the primary example of which is the heretofore untaxed grandchildren's trust.¹³ The present federal law also includes a new orphan's deduction,¹⁴ a method for disclaiming a gift or inheritance,¹⁵ and other amendments and additions, many of them administrative, which have relatively minor effect.

South Carolina, however, has yet to adopt most of these 1976 changes into its estate and gift tax statutes. No unified estate and gift tax system exists; rather, lifetime transfers and estate transfers are taxed separately, with no cumulation at the taxpayer's death.¹⁶ Specific exemptions, instead of credits, are given against both lifetime transfers¹⁷ and estate transfers.¹⁸

In South Carolina, a transfer made in contemplation of death is includible in the gross estate.¹⁹ No tax is imposed on generation-skipping transfers.²⁰ South Carolina has not adopted an orphan's deduction,²¹ a statutory disclaimer provision,²² a rule modifying the inclusion in an estate of joint interests held by the

10. *Id.* § 2040(b). See text accompanying notes 96-102, *infra*.

11. *Id.* § 2032A. See text accompanying notes 85-87, *infra*.

12. See *id.* §§ 6161, 6163, 6166A, 6166, 6324A, 6503, 6601. See text accompanying notes 88-90, *infra*.

13. *Id.* §§ 2601-2622. Herein, the term "grandchildren's trust" refers to a trust in which a beneficiary, belonging to a generation younger than the settlor, has powers and interests in the trust usually limited so that the corpus of the trust would not be includible in that beneficiary's estate for tax purposes upon his death, and in which the interests pass thereafter to a beneficiary in a generation younger than that of the first beneficiary. The goal of a grandchildren's trust is to avoid subjecting the trust corpus to estate tax on the "middle" beneficiary's death. The youngest generation beneficiary need not actually be a grandchild, but must simply be a person in any generation younger than the "middle" beneficiary.

14. *Id.* § 2057. See text accompanying notes 91-95, *infra*.

15. *Id.* § 2518; see *id.* §§ 2041, 2045, 2055, 2056, 2516.

16. See S.C. CODE ANN. §§ 12-15-10, 12-17-10 (as amended by No. 539, 1978 S.C. Acts 1574). See text accompanying notes 38-44, *infra*.

17. *Id.* § 12-17-50 (as added by No. 539, 1978 S.C. Acts 1574). See text accompanying note 45, *infra*.

18. *Id.* §§ 12-15-61, 12-15-251 (as added by No. 539, 1978 S.C. Acts 1574). See text accompanying note 46, *infra*.

19. S.C. CODE ANN. § 12-15-40 (Cum. Supp. 1977). See text accompanying notes 65-66, *infra*.

20. Cf. I.R.C. §§ 2601-02. See section I.E. of this note.

21. Cf. I.R.C. § 2057. See section I.F.4. of this note.

22. Cf. *id.* §§ 2518, 2041, 2045, 2055, 2056, 2514.

decedent,²³ or any of the alternate valuation,²⁴ extension of time payment,²⁵ or other administrative provisions promulgated by Congress. Recent amendments to the South Carolina Code, however, have brought state law into line with federal provisions concerning estate tax marital deductions²⁶ and the equalization of estate tax and gift tax rates in corresponding brackets.²⁷

B. Basic Structure of the Tax System

The Internal Revenue Code establishes an equivalent tax rate in corresponding brackets for transfers during life and for transfers at death. The rate schedule applies to transfers beginning at the base rate of eighteen percent of the taxable amount; as the amount of the transfer increases, the rates increase progressively up to a maximum of 70% for a transfer in excess of five million dollars.²⁸ Obviously, the federal bite can be considerable. Furthermore, the taxing of gifts and of estates is unified; adjusted taxable gifts are added back to a decedent's taxable estate before determining the estate tax due at death.²⁹ Adjusted taxable gifts are those taxable gifts as defined by section 2503 made after December 31, 1976, unless includible in the gross estate.³⁰ Any gift tax previously paid on adjusted taxable gifts is subtracted from the estate tax liability.³¹

In sections 2010 and 2505, the Internal Revenue Code provides for both an estate and a gift tax unified credit, which replace the old specific exemptions.³² After a phase-in period, the maximum credit allowed against either estate or gift taxes in 1981 and thereafter will be \$47,000.³³ The section 2010 credit may be applied up to the maximum credit allowed against all taxable transfers. The section 2505 credit may be applied against all taxable gift transfers up to the maximum credit allowed, but any

23. *Cf. id.* § 2040(c). See text accompanying notes 103-06, *infra*.

24. *Cf. id.* § 2032A. See section I.F.2. of this note.

25. *Cf. id.* §§ 6161, 6163, 6166A, 6166, 6324A, 6503, 6601. See section I.F.3. of this note.

26. S.C. CODE ANN. § 12-15-60 (as amended by No. 539, 1978 S.C. Acts 1574). South Carolina does not, however, require an adjustment in the estate marital deduction ceiling triggered by lifetime transfers to the spouse. See text accompanying notes 52-54, *infra*.

27. Compare S.C. CODE ANN. §§ 12-15-10, 12-17-10 (1976) (as amended by No. 539, 1978 S.C. Acts 1574) with I.R.C. § 2502(a). See text accompanying notes 38-40, *infra*.

28. I.R.C. §§ 2001, 2502.

29. *Id.* § 2001(b).

30. *Id.* § 2001.

31. *Id.* § 2001(b).

32. *Id.* §§ 2010, 2505.

33. *Id.*

unused gift credit may not be added to the estate credit.³⁴ The effect of the unified credit system is to eliminate some of the incentive for making *inter vivos* gifts to reduce estate tax liability. The adjusted taxable gifts that are added to the taxable estate to compute the estate tax use up the section 2010 credit to the same extent that these gifts were covered by the section 2505 credit at the time of transfer. In effect, therefore, the decedent only gets the net value of one \$47,000 credit, regardless of whether he made a lifetime transfer. The adding of adjusted taxable gifts to the taxable estate also prevents a decedent from splitting his estate and using the lower tax brackets with lower rates at the time of his lifetime transfers and at his death. The adjusted taxable gifts raise his estate bracket to the same level that would exist if he had made no gift. A decedent's total estate and gift tax liability is therefore essentially the same whether or not a gift is made, particularly when no tax was payable on the gifts. When gift tax was paid, however, the total estate and gift tax liability will be less than if no gift had been made; the gross estate will not include the amount of gift tax paid unless this tax was paid on transfers within three years of death. In other words, the amount of gift tax paid will be treated as if it had been otherwise consumed.³⁵ The examples below may enhance an understanding of this concept. All examples in this article, unless otherwise specified, are based on several assumptions: (1) no fluctuation in value of property occurs; (2) no transfers are made within three years of death nor in contemplation of death; (3) the section 2503(b) \$3000 exclusion for gift taxation is not figured in; (4) all transfers occur after 1981; (5) only the section 2010 and section 2505 unified credits against federal estate and gift tax, the section 2011 federal credit for state death taxes paid, the federal and South Carolina marital deductions when appropriate, and the South Carolina specific exemptions for estate and gift tax purposes are figured in—other deductions, exemptions, and credits are not considered. Administration expenses are not considered. State taxes are not considered in examples 1 and 2.

Example 1.—*T* owns property worth \$500,000 at his death. Upon his death, his taxable estate is valued at \$500,000. The tax

34. The effect of the § 2505 and § 2010 credits is to allow approximately the first \$175,000 of taxable transfers whether during lifetime or at death, to pass free from tax.

35. Another incentive for lifetime transfers exists. Since § 2001 taxes property in the gross estate at date of death values but § 2501 taxes gift property at date of transfer values, the estate planner may wish to utilize lifetime transfers for property likely to increase in value, especially insurance policies.

imposed by section 2001 on that amount is \$155,800. Section 2010 allows a credit of \$47,000; consequently, the total tax on *T*'s estate is \$108,800. Had *T* made an *inter vivos* gift of \$100,000, the gift tax imposed by sections 2501 and 2502 would have been \$23,800. *T* would have paid no gift tax, however, because of the section 2505 credit of \$47,000. Upon *T*'s death, his taxable estate would include the remaining \$400,000 of post-gift property. Section 2001(b)(1) requires adding back the \$100,000 of lifetime transfers before estate tax liability can be computed. The tax on \$500,000, according to section 2001, is \$155,800. The section 2010 credit of \$47,000 is subtracted therefrom, leaving a total estate tax of \$108,800. The total estate and gift tax is the same whether or not *T* makes any lifetime transfer when no gift tax was paid.

Example 2.—*T* owns property worth \$500,000. Upon *T*'s death, his taxable estate is valued at \$500,000. As in example 1, the total tax on *T*'s estate is \$108,800. Had *T* made an *inter vivos* gift of \$250,000, the gift tax imposed by sections 2501 and 2502 would have been \$70,800. The section 2505 credit of \$47,000 would have been taken therefrom, leaving a total gift tax liability of \$23,800. Upon *T*'s death, his taxable estate would include the remaining \$226,200 of post-gift and post-gift tax property.³⁶ Section 2001(b)(1) requires adding back the \$250,000 of lifetime transfers before estate tax liability can be computed. The tax on \$476,200, according to section 2001, is \$147,708. The section 2010 \$47,000 credit is subtracted therefrom, leaving a total estate tax of \$100,708. Under section 2001(b)(2), the aggregate tax with respect to gifts (\$23,800) would be subtracted from the total estate tax.³⁷ The total estate tax payable by *T*, therefore, is \$76,908. The total estate and gift tax payable by *T* is \$100,708. The total estate and gift tax is lower when a gift large enough to incur gift tax liability is made greater than three years before death than it is when no gift tax is paid.

South Carolina tax rates are substantially lower than the federal tax rates. Section 12-15-10 of the South Carolina Code provides the following structure:

36. This assumes that the gift was not made within the three-year period preceding *T*'s death; otherwise, § 2035(c) would include the amount of gift tax paid in the gross estate. I.R.C. § 2035(c).

37. I.R.C. § 2001(b)(2) in effect credits gift tax actually paid on adjusted taxable gifts that are added back to the taxable estate.

<i>If the taxable estate is:</i>	<i>The tax shall be:</i>
Not over \$40,000	5% of the taxable estate
Over \$40,000 but not over \$100,000	\$2,000 plus 6% of the excess over \$40,000
Over \$100,000	\$5600 plus 7% of the excess over \$100,000. ³⁸

The rates are now equal for lifetime transfers in the corresponding brackets,³⁹ although the gift tax percentages were formerly three-fourths of the estate tax percentages.⁴⁰ Equalization of estate and gift tax rates has removed one of the tax-saving incentives for making *inter vivos* transfers, since the gift tax rates are no longer lower.

Section 12-15-410 imposes an additional tax on South Carolina estates;⁴¹ the additional tax is tied in with Internal Revenue Code section 2011.⁴² Section 2011 allows a credit against federal tax liability, determined from a proration of any death taxes actually paid or payable to the states.⁴³ South Carolina's additional tax is payable only when the credit that would be provided by section 2011 is greater than a taxpayer's liability to this state; the additional tax is the difference between the amount allowable as a credit by section 2011 and the amount payable to South Carolina.⁴⁴ Since the estate can fully utilize the 2011 credit against the federal tax, the total liability for both federal and state tax is no greater because of the additional tax. In essence, South Carolina is diverting funds earmarked for federal taxes into its own coffers. For instance, if the South Carolina tax on an estate were \$100, but section 2011 would allow a credit of \$200 against federal estate tax if the estate had actually paid \$200 or more in state estate tax, South Carolina Code section 12-15-410 would operate to raise the South Carolina tax to \$200. The additional state tax, however, does not increase the combined state and federal estate and gift tax liability. Had the South Carolina

38. S.C. CODE ANN. § 12-15-10 (1976) (as amended by No. 539, 1978 S.C. Acts 1574).

39. *Id.* § 12-17-30 (as amended by No. 539, 1978 S.C. Acts 1574).

40. *See id.* §§ 12-15-10, 12-17-30 (1976).

41. *Id.* § 12-15-410.

42. I.R.C. § 2011.

43. The schedule of the proration of death taxes is set out in the table in I.R.C. § 2011.

44. The South Carolina additional estate tax cannot be computed until there has been a final determination of the federal tax. *Vance v. South Carolina Tax Commission*, 249 S.C. 214, 221, 153 S.E.2d 841, 843 (1967).

tax not been increased from \$100, the actual section 2011 credit that could be taken would be \$100; that credit can be utilized only to the extent of state taxes paid. Therefore, the increase in state tax caused by South Carolina Code section 12-15-410 results in a concomitant and equivalent increase in the section 2011 credit taken against federal taxes. For every dollar increase in the state tax, there is a dollar decrease in the federal tax.

Instead of allowing a credit, South Carolina continues the pre-Tax Reform Act practice of allowing a separate specific exemption for both estate and gift taxes. The amount of the specific exemption for gifts is a cumulative lifetime exemption of \$60,000;⁴⁵ the exemption for estates is \$120,000.⁴⁶ The exemptions, unlike the federal credits, are not unified. Consequently, state tax savings can be realized, as will be discussed below in section II.B.

C. Marital Deductions

1. *Estate Tax Marital Deduction.*—Internal Revenue Code section 2056 allows a federal marital deduction from the gross estate for the value of interests in property that pass to the surviving spouse if the value of that interest is included in the determination of the gross estate.⁴⁷ The interests passing to the spouse must qualify under the provisions of section 2056.⁴⁸ The Tax Reform Act modified the calculation for a marital deduction ceiling. If no lifetime transfer to the spouse has been made, the ceiling on the marital deduction is the greater of \$250,000 or one-half of the value of the adjusted gross estate.⁴⁹ The adjusted gross estate is the gross estate less the deduction for expenses, debts, and taxes provided in section 2053 and the deduction for losses allowed by section 2054.⁵⁰ If a lifetime transfer to the spouse has been made, the ceiling is decreased by the excess of the deductions allowed under the section 2523 gift marital deduction over the deductions which would have been allowed had the amount deductible been one-half of the value of the gift.⁵¹

45. S.C. CODE ANN. § 12-17-50 (1976) (as added by No. 539, 1978 S.C. Acts 1574).

46. *Id.* §§ 12-15-61, 12-15-251 (as added by No. 539, 1978 S.C. Acts 1574).

47. I.R.C. § 2056(a).

48. *See id.* § 2056 for the specific qualifications that property must meet to be considered as passing under the marital deduction.

49. *Id.* § 2056(c)(1)(A).

50. *Id.* § 2056(c)(2)(A).

51. *Id.* § 2056(c)(1)(B). Gifts includible in the donor's gross estate by reason of § 2035 are not taken into account. *Id.* as added by H.R. 6715 § 702(g)(1). For an example of this estate tax marital deduction adjustment, see text at note 57, *infra*.

South Carolina Code section 12-15-60 allows the same deductions and exemptions provided for in section 2056 of the Internal Revenue Code of 1954, as amended through December 31, 1975.⁵² A provision added in 1978 modifies the ceiling computation to the greater of \$250,000 or one-half the adjusted gross estate.⁵³ This provision brings the South Carolina marital deduction partially into line with the Tax Reform Act federal marital deduction. The provision does not, however, impose an adjustment for the marital deductions allowed for lifetime transfers. Consequently, to determine South Carolina's stance on this matter, reference must be made to the Internal Revenue Code as of December 31, 1975, which imposed no such adjustment.⁵⁴

2. *Gift Tax Marital Deduction.*—The Tax Reform Act also modified the federal gift tax marital deduction. Formerly, a tax was imposed on only one-half of the value of a transfer to the spouse. Presently, however, the first \$100,000 of cumulative lifetime transfers is deductible; the next \$100,000 is not deductible; any transfer over \$200,000 is deductible at the rate of one-half of the value of the transfer.⁵⁵ As noted above, utilization of the federal gift tax marital deduction may require a subsequent modification to the estate tax marital deduction ceiling.⁵⁶

Example 3⁵⁷

Amount of Gift	\$100,000	\$150,000	\$200,000	\$300,000
Gift Tax Marital Deduction	100,000	100,000	100,000	150,000
less 1/2 value of gift	50,000	75,000	100,000	150,000
Deduction of Estate Tax Marital Deduction	\$ 50,000	\$ 25,000	\$ -0-	\$ -0-

South Carolina retains the pre-1976 federal gift tax marital deduction formulation;⁵⁸ the allowable marital deduction is one-half

52. S.C. CODE ANN. § 12-15-60 (Cum. Supp. 1977).

53. S.C. CODE ANN. § 12-15-60 (as amended by No. 539, 1978 S.C. Acts 1574).

54. I.R.C. § 2056 (prior to the 1976 Tax Reform Act).

55. I.R.C. § 2523. The discussion in the text does not consider the effects of § 2503(b) at this point, but rather examines the \$3000 annual exclusion for gifts provided thereby in section I.D.3. of this note.

56. See text accompanying note 51, *supra*.

57. G. Maxfield, *Federal Estate and Gift Taxation* 27 (3d ed. 1977). This example does not consider the effect of the I.R.C. § 2503(b) gift tax exclusion of \$3000.

58. S.C. CODE ANN. § 12-17-40 (Cum. Supp. 1977) allows the deductions as provided in I.R.C. §§ 2521-2524 inclusive as amended through December 31, 1975. Section 2523, as noted, allows a marital deduction of 50% of the value of the property interest passing to the spouse.

the value of the gift passing to the spouse.⁵⁹ Utilization of the South Carolina gift tax marital deduction does not require a subsequent adjustment to the estate tax marital deduction ceiling.⁶⁰ The lack of such an adjustment may result in tax savings.

D. Gifts Brought Back Into Gross Estate

1. *In General.*—Not always will a gift made during a taxpayer's lifetime escape inclusion in the gross estate. Federal law requires that a transfer made during the three-year period preceding a taxpayer's death must be included in the gross estate.⁶¹ This provision should not be confused with the procedure set forth in section 2001(b)(1)(B), which deals with adjusted taxable gifts. Adjusted taxable gifts are taxable gifts (within the meaning of section 2503) that are *not* included in the gross estate;⁶² they are added to the taxable estate for section 2001 purposes.⁶³ Since section 2035 gifts are includible in the gross estate, these two types of gifts are mutually exclusive for estate tax purposes. Gifts includible in the gross estate are valued at the date of death regardless of the value at the time of the transfer, whereas adjusted taxable gifts are valued at the time of transfer.⁶⁴ Conceivably, a transfer made within three years of decedent's death could be valued at the date of transfer for gift tax purposes and, if the value had changed, valued at the date of death for purposes of inclusion in the gross estate. The estate planner should be particularly wary of transfers that may increase dramatically in value by the time of the donor's death, and which are likely to be caught up by section 2035.

South Carolina, however, does not have as precise an approach to gifts made near death and includible in the gross estate. Instead, this State retains its reference to pre-1976 federal law by including in the gross estate those lifetime transfers made in contemplation of death.⁶⁵ The tax commission and the courts are left

59. The discussion in the text does not consider the effects of § 2503(b), as incorporated into South Carolina law by S.C. CODE ANN. § 12-17-40, at this time, but rather examines the \$3000 annual exclusion provided thereby in section I.D.3.

60. See text accompanying note 54, *supra*.

61. I.R.C. § 2035(a). The Tax Reform Act amended the pre-1976 contemplation of death rule to this more objective approach.

62. *Id.* § 2001(b).

63. *Id.*

64. *Id.* §§ 2033, 2512.

65. S.C. CODE ANN. § 12-15-40 (Cum. Supp. 1977) provides that the gross estate shall be determined in the same manner as provided in the I.R.C. as amended through Decem-

to decide if transfers were made in contemplation of death.⁶⁶ Possibly, then, a transfer includible in the gross estate under federal law may not be includible for South Carolina tax purposes.

2. *The Federal Gross-Up Rule.*—Another means by which the Tax Reform Act has taken away the tax advantages of lifetime transfers is through the introduction of the “gross-up” rule for gift taxes; section 2035(c) includes within the gross estate any gift taxes paid on transfers made within three years of the decedent’s death.⁶⁷ The taxpayer is consequently unable to make a large deathbed transaction, pay the gift taxes thereon, and have his gross estate at death lessened by the amount of those taxes paid.

Since the gross-up rule was part of the Tax Reform Act, and South Carolina still retains the reference to section 2035 as it read on December 31, 1975, this State has no gross-up rule.⁶⁸ Consequently, another possibility for state tax savings exists, as will be examined in section II.C.

3. *The \$3000 Annual Exclusion.*—Consideration of the \$3000 annual exclusion has been delayed until now because its provisions merit special attention in relation to section 2035. Internal Revenue Code section 2503(b) excludes from the definition of taxable gifts the first \$3000 of property interests (other than gifts of future interests in property) transferred by a donor to a donee.⁶⁹ The \$3000 annual exclusion applies each time a donor gives an excludible amount to a different donee in the same year. No limit exists on the number of years a donor can utilize this device. For example, a donor could give \$3000 to each of ten different donees for ten consecutive years (a total of \$300,000) without having the first dollar designated as a taxable transfer — obviously, an important tax-saving device. Since the annual exclusion provision was not modified by the Tax Reform Act, South

ber 31, 1975. As noted, I.R.C. § 2035 of that time included in the gross estate those transfers made in contemplation of death unless made longer than 3 years before death. A transfer made within three years of death was presumed to be in contemplation of death.

66. *Crawford v. South Carolina Tax Comm’n*, 232 S.C. 113, 101 S.E.2d 267 (1957). Interestingly, section 65-464 of the 1952 South Carolina Code, later repealed, mandated that gifts within three years of death were conclusively made in contemplation of death. The South Carolina Supreme Court held that since the statute did not make the motive behind such a transfer a mere rebuttable presumption, the statute was unconstitutional. *Id.*

67. I.R.C. § 2035(c).

68. See text accompanying note 65, *supra*.

69. I.R.C. § 2503(b).

Carolina's statute is analogous to the federal law.⁷⁰ Gifts excluded under both state and federal sections do not diminish either the federal unified credit against gift tax or the state lifetime exemption.⁷¹

Internal Revenue Code section 2035(b)(2) specifically excludes the application of the three-year rule from "any gift to a donee made during a calendar year if the decedent was not required by section 6019 to file any gift tax return for such year with respect to gifts to such donee. Paragraph (2) shall not apply to any transfer with respect to a life insurance policy."⁷² Section 6019 provides that a donor shall make a gift tax return for all gifts that have a value of less than \$3000 except those excluded by section 2503(b).⁷³ Consequently, section 2035(b) excludes from the gross estate any gift, except insurance, worth less than \$3000 at the time of transfer. A gift worth more than \$3000 is fully includible in the gross estate. Insurance is always includible at the date of death value.⁷⁴

Pre-1976 I.R.C. section 2035, as incorporated into the South Carolina Code by section 12-15-40, did not allow the exclusion now provided in section 2035(b). Consequently, a gift excluded from the reach of section 2035 for federal purposes may nevertheless be includible under South Carolina tax law. The estate planner should note this distinction.

E. The Federal Tax on Generation-Skipping Transfers

One of the largest tax loopholes narrowed by Congress in the Tax Reform Act was the grandchildren's trust.⁷⁵ Prior to the Act, the grandparent testator would leave a large portion of his estate in trust. His child would receive a life estate in that trust, but would not receive enough incidents of ownership to have the value of the trust property included in his gross estate at death.⁷⁶ The grandchildren would receive the remainder of the trust upon their parent's death. The bulk of the estate would be taxable at the

70. S.C. CODE ANN. § 12-17-40 (Cum. Supp. 1977). The South Carolina District Court has held that a spendthrift trust is not a present interest. *Glenn v. Pitts*, 145 F. Supp. 779 (W.D.S.C. 1956).

71. I.R.C. § 2505; S.C. CODE ANN. § 12-17-50 (as added by No. 539, 1978 S.C. Acts 1574).

72. I.R.C. § 2035(b)(2) (as amended by H.R. 6715 Technical Corrections Act).

73. I.R.C. § 6019.

74. *Id.*

75. See note 13, *supra*.

76. See I.R.C. §§ 2036, 2037, 2038.

grandparent's death and at the grandchildren's death, but would escape taxation at the parent's death. Such a scheme proved handy in keeping the estates of wealthy families intact.

Congress ended some of the incentive for creating grandchildren trusts by enacting the federal tax on generation-skipping transfers.⁷⁷ Although the provisions are intricate and deserve careful study by an estate planner, the system itself is basically simple in design. If a decedent were to create a trust similar to the one set out above, his child would have the value of the trust added to his taxable estate at death for calculation of the generation-skipping tax.⁷⁸ The testator's child would be designated the deemed transferor.⁷⁹ The trust itself, rather than the deemed transferor's estate, would incur tax liability when either a taxable distribution⁸⁰ or a taxable termination⁸¹ resulted in favor of the grandchild beneficiary, who belongs to a generation at least two generations younger than the creator of the trust.⁸²

Not all of the advantages of a grandchildren's trust have been eliminated. A \$250,000 exclusion is authorized for each deemed transferor if the beneficiary of the taxable termination or taxable distribution is the grandchild of the trust's creator.⁸³ The marital deduction ceiling of the deemed transferor may also be expanded.

If the generation-skipping transfer occurs at the same time as, or within 9 months after, the death of the deemed transferor, for purposes of section 2056 (relating to bequests, etc., to surviving spouse), the value of the gross estate of the deemed transferor shall be deemed to be increased by the amount of such transfer.⁸⁴

South Carolina has no tax on generation-skipping transfers. State tax savings may result with the proper estate plan, as examined in section II.D.

F. Miscellaneous Comparisons

1. In General.—Several other provisions of the 1976 Tax

77. *See id.* §§ 2601-22.

78. *Id.* § 2602(a).

79. *Id.* § 2612.

80. *Id.* § 2613(a).

81. *Id.* § 2613(b).

82. *Id.* § 2613.

83. *Id.* § 2613(b)(5)-(6).

84. *Id.* § 2602(c)(5)(A).

Reform Act have not been enacted in South Carolina. Although these provisions are perhaps not as important as those heretofore discussed, some are worthy of cursory examination.

2. *Special Valuations for Realty in Farms and Closely Held Businesses.*—Internal Revenue Code section 2032A now allows the representative of an estate to elect to value real property used for farming or in a closely held business based on its value for that use, instead of on the highest and best use, as previously required.⁸⁵ The basic requirements of section 2032A are as follows: the decedent must have been a United States citizen or resident; the full value of the real and personal property of the farm or business must be at least fifty percent of the adjusted value of the gross estate; the full value of the real property must be at least twenty-five percent of the value of the gross estate; the realty must pass to a qualified heir; the realty must have been used as a farm or in the closely-held business for at least five out of the eight years before death; and the decedent or a family member must have materially participated in the farm or business for a like number of years.⁸⁶ The special use valuation cannot reduce the value of the gross estate by more than \$500,000. If the heir disposes of the realty to one other than a qualified heir or if he ceases to use the land as a farm or in the closely-held business, a recapture provision, which phases out the valuation proportionately, takes effect.⁸⁷

Because South Carolina has not adopted a similar valuation alternative, the estate representative may find himself valuing the same real property differently on his federal and state estate tax returns.

3. *Extension of Time to Pay Tax.*—The Tax Reform Act redesignated I.R.C. section 6166 as section 6166A. This section authorizes the estate's representative to elect to pay in installments over a ten-year period the portion of the total estate tax that is attributable to a farm or closely-held business if that property interest exceeds thirty-five percent of the value of the gross estate or fifty percent of the taxable estate.⁸⁸ In addition, Congress enacted a new section 6166. This section allows a fifteen-year extension for that qualifying portion of the total tax.

85. *Id.* § 2032A. For an example of the application of I.R.C. § 2032A, see Carter, *The Application of Section 2032A to the Valuation of Timberland for Federal Estate Tax Purposes*, 29 S.C.L. REV. 577 (1978).

86. I.R.C. § 2032A.

87. *Id.*

88. *Id.* § 6166A.

No tax is payable for the first five years; it is payable in installments for the remaining ten years. The extension is triggered, upon the election of the estate's representative, when the value of a farm or closely-held business exceeds sixty-five percent of the adjusted gross estate.⁸⁹ Furthermore, section 6161 allows the Internal Revenue Service, upon a showing of reasonable cause, to grant up to a ten-year extension for payment of tax owed by any estate; the former standard for the granting of that extension was a showing of undue hardship.⁹⁰ South Carolina has no statutory provisions comparable to sections 6166 or 6166A.

4. *Orphan's Deduction.*—Federal tax law now provides for an orphan's deduction from estate tax liability.⁹¹ If the decedent, having no surviving spouse, is survived by a child, natural or adopted, younger than twenty-one and having no known parent, a deduction is allowed for the property which is includible in the gross estate and which passes to that child.⁹² The deduction is limited for each child to an amount totalling \$5000 multiplied by the number of years that the child is younger than twenty-one.⁹³ For example, an estate could realize a maximum deduction of \$40,000 for qualifying property passing to a thirteen-year old child. To be eligible for the deduction, interests in property must pass according to section 2056(d), which governs marital deductions.⁹⁴ Furthermore, that interest is deductible only to the extent it would have met the terminable interest qualifications of section 2056(b) had the property passed to the spouse, with one notable exception: an interest is not terminable merely because the property will pass to another person if the child dies before the youngest of the decedent's children reaches twenty-three.⁹⁵

South Carolina has no provisions allowing an orphan's deduction for estate tax.

5. *Joint Interests.*—Prior to the Tax Reform Act, the total value of property held jointly by the decedent and another person with right of survivorship was includible in the gross estate; if the survivor could prove that he had provided the consideration for, inherited, or received as donee, all or part of the joint interest, then to that extent a pro rata portion of the value at death could

89. *Id.* § 6166.

90. *Id.* § 6161(a)(2).

91. *Id.* § 2057.

92. *Id.*

93. *Id.* § 2057(b).

94. *Id.* § 2057(d)(3).

95. *Id.* § 2057(c) (as amended by H.R. 6715 § 702(l)(2)).

be excluded.⁹⁶ Present federal law provides an exception. Only one-half of the value of a joint interest is includible if the property is held by the decedent and his spouse, and the property meets a four-step qualifying test:⁹⁷ (1) the joint interest was created by the decedent or his spouse or both; (2) the joint interest was treated as a gift at creation; (3) only the decedent and his spouse are joint tenants; and (4) the joint interest was created after December 31, 1976.⁹⁸

Section 2515 provides that the creation of a joint tenancy in real property between spouses is not a transfer for gift tax purposes.⁹⁹ Creation of a joint interest in personal property does fall within the ambit of section 2515 and is taxable as a gift upon creation. This satisfies the second step for treatment as qualified property under section 2040(b).¹⁰⁰ Section 2515, however, does allow the donor to elect to treat the creation of the joint interest in realty as a taxable transfer.¹⁰¹ Such an election would satisfy the second step for qualification as section 2040(b) property. Thus, the general philosophy behind husband-wife joint interests is that the donor may pay either on creation of the interest or at death, but eventually he must pay tax on the full value apportioned to his contribution.¹⁰²

South Carolina likewise includes within the gross estate the full value of property held jointly by a decedent and another person with rights of survivorship.¹⁰³ Since South Carolina Code section 12-15-40 refers to Internal Revenue Code section 2040 as amended through December 31, 1975, this state does not recognize the section 2040(b)-type exception as authorized by the 1976 Tax Reform Act. The gift tax provisions concerning joint interests remain essentially congruent with the federal law.¹⁰⁴ At first glance, therefore, it appears that certain interests may be taxed

96. *Id.* § 2040(a).

97. *Id.* § 2040(b). This section also provides for a reduction of the value includible in the decedent's estate for decedents dying after December 31, 1978 where his spouse has materially participated in a farm or other business. *Id.* § 2040(c) (as added by H.R. 6715 § 511(a)).

98. Joint interests created before 1977 may qualify if an election is made. *See id.* § 2040(d) (as added by H.R. 6715 § 702(k)(1)(D)(2)).

99. *Id.* § 2515(a).

100. *See id.* § 2515A (as added by H.R. 6715 § 702(k)(1)(A)).

101. *Id.* § 2515.

102. Subject to the § 2503(b) \$3000 exclusion and the estate and gift tax marital deduction. *Id.* §§ 2503(b), 2056, 2523.

103. S.C. CODE ANN. § 12-15-40 (Cum. Supp. 1977).

104. *Id.* § 12-17-40 (as amended by No. 539, 1978 S.C. Acts 1574).

in this state both at the time of creation and at the donor's death. If a donor creates a joint interest with his spouse either in personal property or in real property making a section 2515(a)-type election for taxable treatment, then the interests in both the personalty and the realty are taxable as gifts.¹⁰⁵ Upon the donor's death, the joint interest is fully includible within his gross estate. The effects of double taxation are ameliorated, however, by South Carolina Code section 12-15-30. This section authorizes a credit against the state estate tax for gift tax actually paid.¹⁰⁶

6. *Basis*.—Another aspect of tax law tangentially affected by the differences between federal and South Carolina estate and gift tax law is the calculation of basis of property for income tax purposes. Internal Revenue Code section 1023 provides a carryover basis for decedents dying after December 31, 1979.¹⁰⁷ The basis of one inheriting property is the same as the decedent's basis immediately before his death, with several adjustments.¹⁰⁸ The first adjustment is generally the transitional "fresh-start" adjustment, which applies to property acquired by the decedent before December 31, 1976, and held continuously until his death.¹⁰⁹ Essentially, the basis is adjusted to the fair market value of that property on December 31, 1976.¹¹⁰ The basis is further adjusted for federal and state taxes attributable to appreciation,¹¹¹ for a \$60,000 minimum basis,¹¹² and for state succession tax paid by the transferee,¹¹³ if applicable. The latter three adjustments are utilized only to increase basis.

South Carolina retains the pre-Tax Reform Act federal law stepped-up basis.¹¹⁴ The basis of property passing through the estate is essentially its fair market value at the date of death. As a result of the disparity between state and federal basis provisions, property inherited within this state after December 31,

105. See text accompanying notes 99-102, *supra*.

106. S.C. CODE ANN. § 12-15-30 (1976).

107. I.R.C. § 1023(a) (as amended by H.R. 6715 § 515). The imposition of the carryover basis provisions was to have taken effect after December 31, 1976. Congress deferred the applicable date to December 31, 1979 as part of H.R. 6715; the purpose of this deferral was to allow further study on the effects of the carryover basis. The estate planner should be wary of any subsequent changes to this section once Congress has completed its study.

108. I.R.C. § 1023(a)(1).

109. *Id.* § 1023(h).

110. See *id.*

111. *Id.* § 1023(c).

112. *Id.* § 1023(d).

113. *Id.* § 1023(e).

114. S.C. CODE ANN. § 12-7-910 (1976).

1979, may have a different basis for South Carolina and for United States income tax purposes.

II. SOME POSSIBLE TAX-SAVING PLANS AND DEVICES

A. *In General*

Countless articles have showcased estate plans devised as a response to the 1976 Tax Reform Act and its general loophole-closing policy.¹¹⁵ In each, the emphasis has been to uncover any possible federal tax savings therefrom. This note makes no attempt to add to the exhaustive compilations of federal tax-saving estate plans. The differences between federal and South Carolina estate and gift tax law, however, may provide tax savings that are unavailable in other jurisdictions having different state estate and gift tax laws.

Savings result when the South Carolina estate and gift tax liability is reduced with a concomitant reduction in the federal tax, or at least with no increase in the federal liability. The estate planner, however, should avoid plans in which the South Carolina tax is reduced but the federal tax is increased so that the total state and federal estate and gift tax becomes greater than it would have been without an attempt to save South Carolina tax.

Some examples of estate plans designed to lower South Carolina taxes follow. The estate planner is reminded that these examples are just that — examples. He may attempt to apply the ideas contained in them to the estate plan of each individual client, but he should beware of extracting any generalizations. What may hold true in an example may not apply to a client in a different situation.

Furthermore, the calculations in the examples are simplified in order to focus on the tax savings devices. Unless otherwise specified, the examples assume that no fluctuations in value of property occur, that no transfers are made within three years of death, that all transfers occur after 1981, and that the section 2503(b) \$3000 gift taxation exclusion does not apply. Only the section 2010 and section 2505 unified credits against federal estate and gift tax, the section 2011 federal credit for state death

115. *E.g.*, Patterson, *Who Should Own Your Life Insurance?*, 117 Tr. & Est. 11 (1978); Balmuth, *Is It Still Economical to Make Lifetime Gifts?*, 117 Tr. & Est. 165 (1978); Gamble, *A "Reduce-to-Zero" Marital Deduction Formula for Estates Under \$500,000*, 116 Tr. & Est. 448 (1977); Newman and Kalter, *Disclaimers After TRA*, 116 Tr. & Est. 293; Donaldson, *Inter Vivos Giving in Estate Planning Under the Tax Reform Act of 1976*, 18 WM. & MARY L. REV. 539 (1977).

taxes paid, the federal and South Carolina marital deductions when appropriate, and the South Carolina specific exemptions for estate and gift tax purposes are figured into the calculations. Other deductions, exemptions, and credits are not considered. Administration expenses are not considered. Nontax aspects of estate planning are not touched upon. For instance, the testator's concern for his security in later years may preclude him from making a gift of any great consequence, even though a substantial gift might reduce his total estate and gift tax. In other cases, a deferral of tax payment may be more desirable to a testator than actual tax savings. The next two examples illustrate tax-saving possibilities particularly suited for moderate to small estates in South Carolina.¹¹⁶

Since the \$47,000 federal estate tax credit approximately equals an exemption of \$175,000, while South Carolina's estate tax exemption is only \$120,000, some estates may be small enough to escape federal tax liability yet large enough to incur state liability.¹¹⁷ In these situations, the primary tax-saving goal is to avoid as much state tax liability as possible.

Example 4.—*H* has an estate valued at \$295,000. His wife, *W*, has nothing. In this situation, *H* can maximize the marital deduction, maximize the state exemption, maximize the federal credit, or equalize the two estates. His estate will escape federal tax liability in each instance. His wife's estate will be subject to federal tax when he maximizes the marital deduction. By maximizing the state exemption *H* saves no more money than he would have by maximizing the federal credit, but he defers payment until his wife's death. His wife can invest these tax dollars during her life; payment at *H*'s death would preclude this advantage. By equalizing the two estates, *H* saves more than if he had maximized the state exemption. In some situations, however, a deferral may be of more value than overall tax savings.

Generally, then, if a decedent's estate is small enough to escape federal tax liability, the estate planner will either want to maximize the state exemption and defer payment or equalize the two estates and incur the lowest tax possible. An examination of the individual client's situation will help determine the better plan.

116. These examples do not consider a reduction in the amount of the wife's inherited estate despite any estate taxes payable therefrom.

117. See note 34 and text accompanying notes 45-46, *supra*.

If H leaves W	H's taxable estate	H's South Carolina tax	H's Federal tax	H's total tax	On Widow's death: her estate	W's South Carolina tax	W's Federal tax	W's total tax	Total of both
A. \$250,000 (maximizing marital deduction)	\$45,000	-0-	-0-	-0-	\$250,000	\$7,700	\$21,400	\$29,100	\$29,100
B. \$175,000 (maximizing state exemption)	\$120,000	-0-	-0-	-0-	\$175,000	\$2,900	-0-	\$2,900	\$2,900
C. \$120,000 (maximizing federal credit)	\$175,000	\$2,900	-0-	\$2,900	\$120,000	-0-	-0-	-0-	\$2,900
D. \$147,500 (equalizing estates)	\$147,500	\$1,375	-0-	\$1,375	\$147,500	\$1,375	-0-	\$1,375	\$2,750

At times, however, by attempting to save South Carolina taxes, the decedent may make his wife's estate vulnerable to substantial federal taxes. The estate planner should beware of incurring federal liability as a trade-off for state reductions, as in the following example.

Example 5.—*H* has an estate valued at \$350,000; *W* has 0.

If H leaves W	H's taxable estate	H's South Carolina tax	H's Federal tax	H's total tax	On Widow's death: her estate	W's South Carolina tax	W's Federal tax	W's total tax	Total of both
A. \$175,000 (maximizing federal credit, and equalizing estates)	\$175,000	\$2,900	-0-	\$2,900	\$175,000	\$2,900	-0-	\$2,900	\$5,800
B. \$230,000 (maximizing state exemption)	\$120,000	-0-	-0-	-0-	\$230,000	\$6,300	\$15,480	\$21,780	\$21,780

Federal taxes, starting at a rate of eighteen percent and continuing up to seventy percent, are unquestionably more deleterious to an estate than are state taxes, with a maximum rate of seven percent. The significance of any state taxes is further reduced by the section 2011 credit for state death taxes.¹¹⁸ Therefore, it might seem that utilizing an estate plan to reduce South Carolina taxes is worthwhile only when dealing, as in the above two examples, with smaller estates. In other words, because of the substantiality of federal taxes combined with the effect of the section 2011 credit, it may appear that plans should attempt to create savings in South Carolina taxes only when the estate is small enough to avoid federal taxes but not small enough to avoid state taxes. This, however, may not always hold true. Although an estate plan should not saddle the estate with federal taxes as a result of an attempt to lessen the South Carolina tax, there is no reason why a planner cannot attempt to reduce the state tax

118. See text accompanying notes 41-44 *supra*.

and either lower federal liability or at least not incur additional federal liability. Section 2011 does not nullify such a plan. The credit authorized by section 2011 is less than the taxes imposed by this state on taxable estates up to \$3,700,000, which is the break-even point.¹¹⁹ For instance, a taxable estate of \$3,000,000 draws a South Carolina tax of \$200,200; the section 2011 credit for an estate of that size is only \$182,000. The estate is paying out \$18,200 more in state taxes than the federal credit covers. A plan to reduce the South Carolina tax to the extent it is greater than the section 2011 credit, if it does not increase federal taxes, seems worthy of attempt. Since South Carolina tax law differs from the federal law in several respects, plans may exist that achieve this result. The remaining examples in this article explore some tax-saving possibilities for estates in which both federal and state liability exist.

B. Gifts

The introduction of the unified system for federal estate and gift tax computation has removed some of the incentive for making lifetime transfers to anyone other than the spouse. As illustrated in Examples 1 and 2 above, however, making an *inter vivos* gift only sometimes reduces federal taxes, but it never increases them. Consequently, to reduce the state liability not covered by the section 2011 credit, while further reducing, or at least not increasing, the federal liability, is a worthwhile goal. A gift appears to accomplish these goals in South Carolina because it allows the decedent to utilize both the separate gift and estate exemptions authorized in this state. This plan works in some cases.

Example 6

A. *H* has a \$500,000 estate. *H* dies, leaving all to son *S*.

Gross South Carolina Estate	\$500,000
South Carolina Exemption	\$120,000
South Carolina Taxable Estate	\$380,000

119. The I.R.C. § 2011 credit equals the South Carolina estate tax imposed by S.C. CODE ANN. § 12-15-10 (1976) in taxable estates worth \$3,700,000. In taxable estates smaller than \$3,700,000, the § 2011 credit is less than the South Carolina tax imposed by § 12-15-10. In taxable estates larger than \$3,700,000, the § 2011 credit is greater than the South Carolina tax imposed by § 12-15-10. Only in the latter situation does § 12-15-410 operate to impose an additional state tax. See I.R.C. § 2011; S.C. CODE ANN. § 12-15-410 (1976); S.C. CODE ANN. § 12-15-10 (1976) (as amended by No. 539, 1978 S.C. Acts 1574).

South Carolina Estate Tax	\$25,200
Gross Federal Estate	\$500,000
Taxable Federal Estate	\$500,000
Tentative Federal Tax	\$155,800
Section 2010 Credit	\$47,000
Section 2011 Credit	\$10,000
Total Federal Estate Tax	\$98,800
Total Federal and South Carolina Tax	\$124,000

B. *H* has an estate of \$500,000 and makes a gift of \$60,000 to son *S*. *H* then dies, leaving all to *S*.

Gross South Carolina Gift	\$60,000
South Carolina Exemption	\$60,000
South Carolina Taxable Gift	-0-
South Carolina Gift Tax	-0-
Taxable Federal Gift	\$60,000
Tentative Federal Gift Tax	\$13,000
Federal Gift Credit	\$47,000
Total Federal Gift Tax	-0-
Total Federal and South Carolina Gift Tax	-0-
Gross South Carolina Estate	\$440,000
South Carolina Exemption	\$120,000
South Carolina Taxable Estate	\$320,000
South Carolina Estate Tax	\$21,000
Taxable Federal Estate	\$440,000
Federal Adjusted Taxable Gifts	\$60,000
Total	\$500,000
Tentative Federal Tax	\$155,800
Section 2010 Credit	\$47,000
Section 2011 Credit	\$8,080
Total Federal Estate Tax	\$100,720
Total Federal and South Carolina Estate Tax	\$121,720
Total Federal and South Carolina Estate and Gift Tax	\$121,720

By making a \$60,000 lifetime transfer, as in Part *B* of Example 6, *H* effectively saves \$2280 on what his total tax liability would have been without a gift, as in Part *A* of Example 6. Utilization of the separate \$60,000 gift tax exemption allows that amount of property to pass tax free; had there been no gift, the estate would

have included an additional \$60,000 of taxable property even though the estate tax exemption would remain constant. This savings comes directly from that South Carolina tax payable in excess of the section 2011 credit allowable. The estate planner should beware of making the generalization that the above plan always results in tax savings. The section 2011 credit can be taken only to the extent of state tax actually paid.¹²⁰ More importantly, the section 2011 credit must be computed only from the adjusted taxable estate.¹²¹ The adjusted taxable estate does not include adjusted taxable gifts that are added back to the gross estate for calculation of the estate tax.¹²² If a gift is made, the taxable estate is reduced to that extent. When the adjusted taxable gifts are added back to the taxable estate, the section 2011 credit is not increased to that extent. Although the adjusted taxable gifts when added back increase the total federal estate tax, they do not increase the section 2011 credit. The section 2011 credit is not allowed against any gift tax liability. The estate planner should avoid situations in which gifts cause a reduction in total state liability, but also create a reduction in the section 2011 credit which overcomes any savings in the state taxes.

Example 7.—*H* has \$500,000. He dies, leaving all to son *S*. As in Example 4, *H*'s South Carolina estate tax liability is \$25,200 and the federal tax is \$98,800, for a total tax of \$124,000. *H* gives *S* \$250,000. He dies, leaving all to son *S*.

Example 7

H has \$500,000. He dies, leaving all to son *S*. As in Example 4, *H*'s South Carolina estate tax liability is \$25,200 and the federal tax is \$98,800, for a total tax of \$124,000. *H* gives *S* \$250,000. He dies, leaving all to son *S*.

Gross South Carolina Gift	\$250,000
South Carolina Exemption	\$60,000
South Carolina Taxable Gift	\$190,000
South Carolina Gift Tax	\$11,900
 Taxable Federal Gift	 \$250,000
Tentative Federal Gift Tax	\$70,800
Federal Gift Credit	\$47,000
Total Federal Gift Tax	\$23,800

120. I.R.C. § 2011.
121. *Id.*
122. *See id.* §§ 2001(b), 2011.

Total South Carolina and Federal Gift Tax .. \$35,700

Gross South Carolina Estate \$214,300

South Carolina Exemption \$120,000

South Carolina Taxable Estate \$94,300

South Carolina Estate Tax \$5,258

Taxable Federal Estate \$214,300

Federal Adjusted Taxable Gifts \$250,000

Tentative Federal Tax \$143,662

Federal Estate Credit \$47,000

Section 2001(b)(2) Credit \$23,800

Federal Section 2011 Credit \$1,543

Total Federal Estate Tax \$71,319**Total Federal and South Carolina Estate Tax \$76,577****Total Federal and South Carolina Estate and
Gift Tax \$112,277**

By making a lifetime transfer of \$250,000, *H* has reduced not only his South Carolina tax liability, but his federal taxes as well. State tax is lowered because the \$60,000 gift tax exemption was utilized. The federal tax was lowered and the state tax was further reduced because the South Carolina and federal gift tax paid resulted in a smaller estate at death, as in examples 1 and 2. *H*'s total tax liability is less than if he had made no gift.

The above examples illustrate that the use of gifts may ultimately save tax dollars in South Carolina, but perhaps only in certain situations. The estate planner should determine whether his client's plan falls within these situations.

C. Gifts Within Three Years of Death

Federal law, by adding back into the gross estate not only gifts made within three years of death but also gift taxes paid on them, does not allow these gifts to reduce the total gross estate or the tax liability.¹²³ South Carolina lacks this "gross-up" rule. As a result, a South Carolina decedent having made a gift, even though includible in his gross estate because it was in contemplation of death,¹²⁴ will have reduced the gross estate to the extent gift taxes were paid. The reduced gross estate, along with the

123. I.R.C. § 2035(a) and (c).

124. For discussion of the state contemplation of death rule as compared with the federal three-year rule, see section I.D. of this note.

section 12-15-30 credit for gift taxes paid on gifts includible in the gross estate,¹²⁵ may reduce that part of the South Carolina estate tax that is greater than the section 2011 federal credit. The federal estate tax will be lower because the gross estate will be less.¹²⁶ The estate planner should remember that section 2011 covers only state taxes actually paid and be wary of situations in which the section 2011 credit is reduced because no state tax was paid, perhaps increasing the total tax liability. Unless a plan would result in a lower section 2011 credit, however, the lack of a state gross-up rule should provide some tax relief.

Example 8.—*H* has \$500,000. He gives \$250,000 to persons other than his spouse within three years of death, paying the taxes on the gift. The amount of the gift and the amount of federal gift tax are included in the gross estate under I.R.C. section 2035(a) and (c). In South Carolina, the state taxes paid on that gift are not includible in the gross estate.

Example 8

H has \$500,000. He gives \$250,000 to persons other than his spouse within three years of death, paying the taxes on the gift. The amount of the gift and the amount of federal gift tax paid are included in the gross estate under I.R.C. Section 2035(b). In South Carolina, the state taxes paid on that gift are not includible in the gross estate.

South Carolina Gift Tax	\$11,900
Federal Gift Tax	\$23,800
Total Gift Tax	\$35,700
 Federal Gross Estate	 \$488,100
Federal Estate Tax	\$71,335
Total Federal Estate and Gift Tax	\$95,135
 South Carolina Gross Estate	 \$464,300
South Carolina Estate Tax	\$10,801
Total South Carolina Estate and Gift Tax	\$22,701
Total Federal and South Carolina Estate and	
Gift Tax	\$117,836
 Total Federal and South Carolina Estate and	
Gift Tax Had There Been no Gift	\$124,000

125. S.C. CODE ANN. § 12-15-30 (1976).
126. See examples 1 and 2 in section I.B. of this note.

The gift resulted in a savings of \$6164.00 of South Carolina and federal taxes.

D. Generation-Skipping Transfers

The Tax Reform Act, in promulgating the generation-skipping provisions, did not invalidate all of the advantages in setting up a grandchild's trust.¹²⁷ Although a member of the middle generation in the trust is considered a deemed transferor for the purpose of the generation-skipping transfer tax,¹²⁸ some relief results from the \$250,000 grandchild exclusion¹²⁹ and the increased estate tax marital deduction ceiling.¹³⁰ Consequently, the total tax bite is considerably less than it would have been if no grandchild's trust had been set up. Generation-skipping taxes are payable out of the trust, with the distributee liable to the extent of the value of his distribution and the trustee liable to the extent of a taxable termination.¹³¹ When considering any possible advantages of a generation-skipping trust, the estate planner should therefore consider total tax liability, since the deemed transferor is not primarily taxed for generation-skipping purposes.

South Carolina has no generation-skipping transfer tax. Substantial tax savings can result. The savings are equal to what the South Carolina estate tax would have been had the property passed through the estate of the grandchild's parent, minus the proportion of section 2011 credit for that amount which cannot be used since no state taxes are paid on that property. For example, if the grandfather (A) had set up a \$500,000 grandchild's trust and his child (B) had an estate of \$500,000 at death, only that child's (B's) \$500,000 is taxable in this state. The \$500,000 trust property (minus the appropriate exclusion and deductions) is taxed for federal generation-skipping purposes only. Because the grandchild's trust property escapes South Carolina tax liability in the child's generation, the net South Carolina savings is considerable, even after figuring in the section 2011 credit which will not be allowable to the extent that no state taxes are paid.

127. See note 13, *supra*.

128. I.R.C. § 2612.

129. *Id.* § 2613(b)(5), (6).

130. *Id.* § 2602(c)(5)(A).

131. Further savings can be realized by making § 2613 taxable distributions in certain situations. The distributed property is actually taxed at a lower percentage rate than the credit for that same property which is later taken from the tax on any termination. See I.R.C. §§ 2613, 2602.

This amount is, of course, in addition to any federal savings realized from the use of a grandchild's trust.

III. CONCLUSION

This article is not a comprehensive primer on estate planning. It merely focuses on some of the more important differences between South Carolina and federal estate and gift tax law. The examples relating to possible tax-saving plans are not intended to espouse generalizations. Rather, estate planners should utilize these examples only as a springboard for their own ideas for tax savings, being careful to ascertain that these devices will apply to a particular client's situation. Furthermore, the examples in this note dealing with tax-saving plans consider the possibility of reduction in taxes resulting solely from the disparity in state and federal law. Myriad other devices exist outside the ambit of this article. For instance, an annual interspousal *inter vivos* transfer of \$6000 per year can be an effective means of reducing estate and gift tax liability; the section 2523 gift tax marital deduction in conjunction with the section 2503 \$3000 annual exclusion operates to remove any tax from such a transfer without reducing the federal credit or the state lifetime exemption.¹³²

The examples were streamlined to dramatize the disparity between the two bodies of law and the resulting possibility of savings. In actual practice, the computations would have necessarily included consideration of all credits, adjustments, deductions, and exemptions. One important omission was the consideration of the section 2503(b) \$3000 exclusion in the examples in which gifts were a part of the estate plan. Certain other tax-related considerations not stemming particularly from the South Carolina-federal differences were either omitted or only touched upon. For example, in deciding whether to make an *inter vivos* transfer, an important factor is the possibility that the property will increase in value. If the gift is made and section 2035 does not come into play, that property will be taxed at its value on the date of transfer; if the gift is not made, that property will be taxed at the higher value on the date of death. The cursory treatment of this consideration within the examples and discussion may have made this factor appear less important than it is.

Most importantly, the estate planner should constantly be

132. See *id.* §§ 2523(a), 2503(b). This gift may have an effect on the adjustment to the estate tax marital deduction ceiling. *Id.* § 2056(c)(1)(B).

aware of the maxim which cautions against the tax tail wagging the dog. The foremost goal should be the creation of a plan which effectuates the needs and desires of the client as practically as possible; tax-saving devices should than be employed within the parameters of this plan. For instance, the wife's ability to manage property or the possibility of subsequent problems in a marriage may dictate the shape of an estate plan. Deferment of taxes in some situations may be more valuable than overall tax savings. Also, a client, before making a gift, should be certain that he has sufficient remaining assets both for his own use and to avoid liquidity problems in his estate.

There is always a temptation to over-emphasize in a discussion of estate planning the feature of estate tax reduction. It is more dramatic and concrete and the figures for the amount saved may be large. As a matter of fact, the term estate planning has been criticized as connoting tax avoidance. However, estate tax avoidance or reduction is only one, albeit an important one, feature of an estate plan.

The basic objective of any testator is to leave his dependents adequate financial security However, no matter what arrangements are made to provide financial security for dependents, it is an essential part of such arrangements to reduce the administration expenses and estate taxes to a minimum.¹³³

With these goals in mind, some of the ideas contained in this note should provide a starting point from which the estate planner may create an effective and efficient plan individually tailored to his client's needs with minimum tax liability.

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133. Bruton, *Estate Planning*, 2 S.C.L.Q. 103, 105-06 (1949).

